

# memorandum

date: JAN 29 1999

to: Chief, Examination Division  
David Couch, Revenue Agent  
Examination Division, Large Case

from: Michael F. Steiner  
Attorney  
District Counsel

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subject: [REDACTED]  
TL-N-102-99

## DISCLOSURE STATEMENT

This is in response to your request for assistance in connection with the above captioned taxpayer. This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

## FACTS

The facts, as we understand them, are as follows. [REDACTED] and [REDACTED] entered into two agreements dated [REDACTED]. The agreements were titled "Technology and Manufacturing Agreement" (Technology Agreement) and "[REDACTED]" (Warrant Agreement). Simply stated, under the Technology Agreement, [REDACTED] was to design, market and sell chips using [REDACTED] provided technology. [REDACTED] was to provide the technology and additional assistance in the process. [REDACTED] also invested \$[REDACTED] in [REDACTED] for the purchase of stock and a warrant. The Technology Agreement specifically states that [REDACTED] intends to make a "substantial equity investment" in [REDACTED] in order to assist [REDACTED] with the startup expenses, improve [REDACTED]'s

financial position and create public recognition of [REDACTED]. [REDACTED] actually exercised the warrant on [REDACTED]. [REDACTED] claimed a deduction in the amount of \$[REDACTED]<sup>1</sup> on its FY [REDACTED] income tax return under "Other Deductions" as a "Write off [REDACTED] Project.

You requested our opinion of [REDACTED]'s treatment of the warrant exercise. You referenced the cases of *Sun Microsystems v. Commissioner* TC Memo 1993-467 and *Convergent Technologies, Inc. v. Commissioner*, TC Memo 1995-320 and stated that you believed these cases to be substantially different from the [REDACTED] situation. We agree.

### ANALYSIS

In *Sun* the taxpayer issued a warrant for the purchase of its stock to one of its customers. The warrant was only exercisable upon the purchase of a specific amount of products from Sun. The Tax Court found that the warrant and the sales transactions were both part of an integrated transaction, even though the documents specifically stated otherwise. The Tax Court looked to the totality of the arrangement and determined that the transactions were integrated.

Similarly, in *Convergent Technologies v. Commissioner*, TC Memo 1995-320, the taxpayer issued a warrant to a customer which was exercisable after that customer had reached a specified amount in purchases. The Tax Court again held for the taxpayer on the question of deductibility of the difference between the market price and the exercise price of stock issued pursuant to the warrant.

In both of the above cases, the warrants were tied directly to the purchase of product from the company which issued the warrant. In the [REDACTED] case, the warrants were granted as part of an equity investment by [REDACTED] in [REDACTED]. The equity investment was tied to the agreement between the companies to perform a joint venture. It appears from the documents provided to our office that [REDACTED] simply wanted an equity interest in [REDACTED] in the event that the joint venture produced positive results for both companies. This being the case, we agree with you that the [REDACTED] case is distinguishable from the *Sun* and *Convergent* cases.

As we discussed in our telephone conversations, we believe that it would strengthen your case to ask [REDACTED] for the names, addresses and phone numbers of the employees of both [REDACTED] and [REDACTED] who negotiated these agreements. We request that you interview those individuals to determine if their testimony will support the information contained in the written agreements. We also believe it would be advisable to ask [REDACTED] for the name of the people who drafted these agreements. Finally, we request that you inquire as to whether or not [REDACTED] had any loans of any type outstanding to [REDACTED] during the time period involved here.

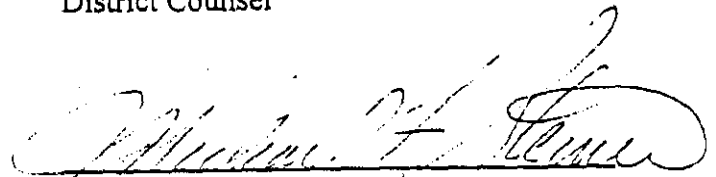
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<sup>1</sup>This amount represents the difference between the Warrant exercise price of \$[REDACTED] and the market price on date of exercise of \$[REDACTED] for [REDACTED] shares.

Please keep us advised of any documents and/or new information you uncover. Also, feel free to contact our offices with any further questions you might have.

BARBARA M. LEONARD  
District Counsel

By:

A handwritten signature in dark ink, appearing to read "Michael F. Steiner", written over a horizontal line.

MICHAEL F. STEINER  
Attorney